No. 82-1483

IN THE

Supreme Court of the United States

October Term, 1982

SIMONE C. ANDRE,

Petitioner,

-against-

MERRILL LYNCH READY ASSETS TRUST, MERRILL LYNCH ASSET MANAGEMENT, INC., MERRILL LYNCH, PIERCE, FENNER & SMITH INC. and IRVING L. GARTENBERG,

Respondents.

REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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I. INTRODUCTORY STATEMENT

Respondents, in their brief, have stated that the petition raises no issue warranting review by the Court. Petitioner submits that this statement

misrepresents the importance of the instant case and is patently false.

The decision by the Second Circuit is to petitioner's knowledge, the first decision rendered after trial, interpreting § 36(b) of the Investment Company Act. As such, it will serve as a benchmark for all future decisions involving litigation challenging the conduct of investment advisers who allegedly charge mutual funds excessive advisory fees. Moreover, since the instant suit involves by far, the largest advisory fee in the industry, the practical effect of the Second Circuit's erroneous interpretation of § 36(b) will be to give carte blanche to advisers charging lesser fees which, under a correct standard, would be found to violate the Act. For this reason, among others stated in the petition, it is of paramount importance that the

Court review the decision of the Court of Appeals.

II. RESPONDENTS HAVE IGNORED THE ISSUES RAISED BY THE PETITION

Section 36(b) was enacted by Congress, in large measure, because of the perceived failure of the common law and the Investment Company Act as it then stood, to protect shareholders of mutual funds from overreaching investment advisers. By passing § 36(b), it is clear that Congress sought to augment the common law protections afforded fund shareholders, and not to pre-empt or supercede them.

Nevertheless, as petitioner stated in her petition, the effect of the Second Circuit's opinion in the instant case is to do just that, namely, to eliminate basic safeguards found in ordinary corporate law and in the securities laws. While respondents have

labelled petitioner's position as "fanciful", they have chosen not to rebut petitioner's contentions but instead, with one exception, have limited themselves to the issue of excessiveness. Most conspicuously, respondents do not even mention or refer to the most far-reaching determination of the Second Circuit, i.e., that it is the duty of the independent directors of the fund to ferret out all material facts, not as the statute provides, the duty of the investment adviser to provide such information to them.

While respondents argue that the decision of the Court of Appeals "places heavy burdens of disclosure on investment advisers,"* in fact it removes virtually all such burdens.

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* Respondents' Brief, p. 10.

For, according to the Second Circuit, a failure to disclose material facts is actionable only if the undisclosed facts demonstrate that the advisory fee is excessive.* Thus, the Second Circuit has constricted the broad "fiduciary duty" imposed by Congress upon investment advisers, so that their duty now relates only to the size of their fee. Accordingly, whether an investment adviser has breached its fiduciary duty now hinges not upon whether it has made full disclosure, but solely upon whether it has charged an excessive advisory fee. For whether an adviser has made full disclosure or not, the burden of proof placed by the court below, upon a plaintiff in any action under § 36(b), is ultimately to show that the advisory fee is unfair. This

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* A. 22

is clearly in error, and is not the burden of proof contemplated by Congress.

It is clear from the legislative history of the 1970 Amendments to the Act that in enacting § 36(b) Congress intended to correct prior deficiencies therein, not to exacerbate them. It is patent that a cornerstone of the Act is that full disclosure be made, so that non-affiliated trustees might make informed decisions. Having shown that in this case, all material facts were not disclosed to the funds non-affiliated directors, which under judicial interpretations of the Act prior to the enactment of §§ 15(c) and 36(b) was by itself, a breach of fiduciary duty,* petitioner

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* Moses v. Burgin, 445 F.2d 369 (1st Cir.), cert. denied sub. nom. Johnson v. Moses, 404 U.S. 994 (1971); Fogel v. Chestnutt, 533 F.2d 731 (2d Cir.) cert. denied 435 U.S. 943 (1978); Papilsky v. Berndt, [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH ¶ 95.627 (S.D.N.Y. 1976).

has met her burden of proving that respondents violated § 36 (b). Accordingly, the decision of the Second Circuit must be reviewed.

III. RESPONDENTS HAVE FAILED ADEQUATELY TO REBUT THE CONTENTION THAT DISCLOSURE TO THE SHAREHOLDERS WAS INADEQUATE.

Respondents all but ignore petitioner's argument that all material information was not disclosed to the shareholders. Stating that all material facts were revealed, respondents merely beg the question as to what is material.

This is particularly evident in respondents' discussion of the Second Circuit's opinion in the case of Tannenbaum v. Zeller*. Thus, respondents fatuously distinguish Tannenbaum from the instant case, by stating that

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* 552 F.2d 402 (2d Cir.) cert. denied, 434 U.S. 934 (1977).

in the former suit all material information was not disclosed to the shareholders, while herein, all relevant facts were disclosed. Of course, the issue not addressed by respondents, is what facts were material, and were required to be disclosed to the shareholders.

According to the Second Circuit, the only fact which must be disclosed to shareholders under § 36(b), was that the non-affiliated trustees "had considered extensive relevant information."* Taking certain language of § 36(b), which was intended to add protections to those already afforded shareholders, namely that shareholder approval of the advisery contract "may be given such considera-

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* A 23.

tion by the court as is deemed appropriate,"* the Second Circuit distorted such language to mean that disclosure which is not even adequate under corporate common law** is sufficient under § 36(b).

The decision of the Second Circuit is clearly in error, and its impact will be to allow all investment advisers, in the future, to ignore the requirement of shareholder disclosure. Accordingly, it must be reviewed.

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* The legislative history of § 36(b) makes clear that this language was inserted to prevent courts from using shareholder ratification as a device to invoke the "corporate waste" standard, a device utilized in Saxe v. Brady, 40 Del. Ch. 404, 197 A.2d 49 (Ch. 1964).

** See, e.g., Lynch v. Vickers, 383 A.2d 278 (Del. Supr. Ct. 1977).

IV CONCLUSION

For all of the reasons set forth above, as well as in the petition, a writ of certiorari should be granted to review the opinion and judgment of the United States Court of Appeals for the Second Circuit.

Dated: New York, New York
April 13, 1983

Respectfully submitted,

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